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Before the
Special Committee on Aging
United States Senate

"Protecting Senior Citizens Against Investment Fraud "

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Chairman Smith, Ranking Member Kohl and Members of the Committee,

I'm Patty Struck, Wisconsin Securities Division Administrator and President of the North American Securities Administrators Association, Inc. (NASAA).[1] I am honored to have the opportunity to appear before your Committee to highlight the activities of state securities regulators in protecting senior citizens against investment fraud.

Overview

The securities administrators in your states are responsible for licensing of firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, enforcing state securities laws, and providing investor education programs and materials to your constituents. Like me, some of my colleagues are appointed by their Governors and Cabinet officials, ten are appointed by state Secretaries of State and five fall under the jurisdiction of their states' Attorneys General. We are often called the "local cops on the securities beat," and I believe that is an accurate characterization.

My staff and I interact daily with elderly investors. These interactions are often the result of senior investor education seminars or complaints lodged by seniors with my office. In addition to educational initiatives that target seniors, my office works with criminal authorities to prosecute companies and individuals who commit crimes against seniors, and we bring civil actions for injunctions, restitution and penalties against companies and individuals who commit securities fraud. We also educate seniors through publications, videos and seminars so that they are better able to protect themselves. For example, the Financial Literacy Section of the Wisconsin Department of Financial Institutions has developed numerous investor education brochures and related materials on a variety of investment, financial, and consumer education matters. Specifically with regard to outreach to seniors, the Section sponsors numerous outreach activities, including multi-media presentations around the state on the subject of "How Seniors Can Keep from Being Victimized by Investment Fraud."

NASAA's annual Spring Public Policy Forum traditionally focuses on the issues of greatest importance to regulators, the industry and the investing public. This year, given the increased public awareness of our nation's changing demographics, NASAA felt it was important to examine the business, policy and investor protection challenges raised by the growth in our senior population.

While our cases of senior investment fraud may not make national headlines, they are devastating in their impact to the victims and their families. What would you do if your mother or father turned over their retirement nest egg to a smooth-talking "senior specialist" who promoted unsuitable investments?

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[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was founded in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

In the United States alone, an American turns 50 once every seven seconds and on January 1, 2006, the first of an estimated 77 million baby boomers, those Americans born from 1946 to 1964, celebrated their 60th birthday. The 50-plus population is the fastest growing segment worldwide and predicted life expectancies are at a historical high.

Boomers have more than $8.5 trillion in investable assets. Over the next 40 years, they stand to inherit at least $7 trillion from their parents, research firm Cerulli Associates estimates.

Facing greater responsibility for their financial security stemming from the decline of traditional defined benefit pension plans, and with greater life expectancies, it should be no surprise that retirees today are seeking to maximize their retirement investments.

Investment Fraud Against Seniors

While people age 60 and older make up 15 percent of the U.S. population, they also account for about 30 percent of fraud victims, estimates Consumer Action, a consumer-advocacy group. As baby boomers swell the retiree population, state securities regulators are concerned that financial scams targeting seniors also will rise and based on our collective experience of over seventy-five years of securities regulation we believe our concerns are well-founded. Con artists read the headlines, and they need little encouragement to emerge from the side streets and back alleys to Main Street where older investors live.

Seniors today are bombarded with pitches for financial seminars. There are ads in the newspapers and on the radio. Cold callers, brokers, financial planners, and insurance agents are all pitching investments to seniors. Many of them are promising "higher returns and little or no risk." Those words are a red flag for investors. Unfortunately, in many of the cases that securities regulators see, it's just the opposite: high risk and no returns, just devastating losses.

No one knows exactly how many older Americans are victims of investment fraud. Often, older victims don't report crimes because they don't want people to know they have lost money or made an unsound investment. Also, they don't know how or where to complain. Through seminars, publications, public service announcements, and press interviews, my fellow regulators regularly stress how important it is that seniors and all investors should always call their state securities regulator if they have questions about an investment opportunity or if they suspect they have been a victim of investment fraud. We have local offices in every state and our staffs are trained to respond to all complaints. You can find a list of regulators on the NASAA website at www.nasaa.org

Before investing, seniors should first contact their state, territorial, or provincial securities regulator to see if the investment vehicle and the person selling it are registered. Your state or provincial securities regulator will also be able to tell you if the salesperson has a disciplinary history, that is, whether any civil, criminal or administrative proceedings have been brought against him or her. The best advice is to first call a state securities regulator before investing to check out any product and the person selling it.

Three Noteworthy Trends at the State Level

The targeting of seniors for investment schemes is a chronic problem. My colleagues and I are currently seeing a proliferation of troubling schemes in three related areas: "senior specialists," variable annuities, and unlicensed/unregistered persons. Unfortunately, these three problems often occur simultaneously at certain senior investment seminars.

Senior Specialists - State securities regulators are receiving an increasing number of complaints from investors who have been enticed into attending seminars sponsored by certain "senior specialists." While there are organizations whose members must complete rigorous programs of study and pass extensive examinations, there are also organizations that require little or no training in order to use one of these designations. Typically, the designation will indicate that the holder has some form of expertise in assisting seniors in structuring their investments in such a manner as to reduce taxes, minimize risk and avoid state probate laws.

It is common practice for seniors to receive an invitation to a seminar, usually conducted with a meal, such as a prime rib dinner, where, at the conclusion of the seminar attendees are encouraged to contact the presenter with further questions. Typically, the specialist recommends liquidating securities positions and using the proceeds to purchase fixed, indexed or variable annuities products the specialist offers. Under our state securities laws, these recommendations may be viewed as providing investment advice for compensation. In such cases, the "senior specialist" would be offering investment advice as an unregistered investment adviser and, therefore, be subject to enforcement action by regulatory agencies.

State securities regulators have opened 26 cases in the past year involving "senior specialists" in the eastern half of the United States alone. Most of the cases involve securities recommendations by individuals who are not properly licensed by state securities regulators.

A recent enforcement action by Massachusetts securities regulators against Investors Capital Corp. illustrates how a "senior specialist" designation can be used to hoodwink seniors. According to state regulators, one of the firm's representatives stated during a seminar that his senior specialist designation – received by taking a three-day course or a home course, followed by a multiple-choice exam – indicated that he had been specifically trained to manage and solve financial problems facing seniors. According to the state, the seminar steered investors toward investing in equity-indexed annuities as the best way to participate in stock market gains without risk. Equity-indexed annuities are complex insurance products with high commissions and long holding periods (as well as stiff penalties for early withdrawals), which make them unsuitable for many older investors. In November, the state charged the firm with misleading investors, especially seniors, into buying equity-indexed annuities.

Variable Annuities - A perennial fixture on NASAA's annual list of top scams involve the sale of variable annuities to investors with little regard to whether or not the product is suitable. While these are legitimate and suitable investments for some, regulators are concerned that many investors aren't being told about high surrender charges for early withdrawals, the potential of exposure to market risk, and the steep sales commissions agents often earn when they move investors into variable annuities. Often pitched to seniors through investment seminars, these products are unsuitable for many retirees. Some investors also are misled with claims of guaranteed returns when variable annuity returns actually are vulnerable to the volatility of the stock market. While variable annuities certainly have benefits – tax-deferral and death benefits among others – they come with strings attached and additional costs. Investors should be aware of these costs and impact of the costs on the performance of these products. High commissions often are the driving force for sales of variable annuities.

Variable annuities are considered to be securities under federal law and the laws of some states. Other states, however, consider variable annuities to be insurance products and others consider them to be both insurance and securities. NASAA is encouraging changes in state laws that would allow state insurance regulators to continue to oversee the insurance companies that sell variable annuities while authorizing state securities regulators to investigate complaints about variable annuities and to take action against the individuals who sell them. These simple statutory amendments are not intended to give states the power to register the products themselves, only to ensure that states securities regulators have the much-needed authority to regulate the agents who sell them.

Most of the sales practice complaints received by state securities regulators involving variable annuities relate to the suitability of the product. While a suitability standard has been proposed, we feel that the commonly accepted methodology for determining the suitability of an investment should be applied. In pertinent part, the standard is as follows:

> In recommending to a customer the purchase, sale, or exchange of a security, a broker-dealer, salesperson, investment adviser, or investment adviser representative must have reasonable grounds for believing that the recommendation is suitable for the customer upon the basis of the facts, if any, disclosed by the customer as to his or her other security holdings and as to his or her financial situation and needs.

Unregistered/Unlicensed Individuals - Another problem area inundating state regulators is unlicensed securities sellers pitching securities that are unregistered. Individuals who sell securities or provide investment advice are required to earn a license by passing rigorous examinations before they can offer their services to the public. Those who bypass this requirement often are predators offering bogus investments. Unlicensed people selling unregistered securities should be a red alert for investors. Con artists also frequently use the promise of high commissions to lure some insurance agents, investment advisers, accountants, and lawyers who are not licensed to sell securities into selling investments they may know little about, such as bogus limited partnerships or promissory notes. Many of the enforcement cases described below illustrate the twofold violation of persons not licensed with their state securities regulators selling unlicensed products.

I return to the simple advice that could help seniors and all investors avoid the pitfalls of investment fraud: call your state securities regulators before investing. We're there to help educate investors about their rights and to provide the tools and knowledge needed to make informed financial decisions.

Enforcement and Education

So what can be done to combat investment fraud against seniors? State securities regulators believe the most effective weapon against fraud is a dual approach: combine aggressive enforcement efforts with financial education to protect investors from unscrupulous individuals.

State securities regulators have a long history of protecting investors at the local level day in and day out. Enforcement against fraud is the essence of what state and provincial regulators do – to vigorously pursue sales practice abuses and a variety of scams and frauds against unsuspecting senior investors. The following cases illustrate the work being conducted by state securities regulators on a daily basis to protect seniors from investment fraud.

In my own state of Wisconsin, Kenneth Hackbarth, an elder in his local church in Kenosha WI, operated a long-running Ponzi scheme that victimized a total of 117 friends, relatives and parishioners (mostly seniors) of over $6 million. Two of the fraud victims committed suicide from being so financially devastated by the fraud. Using a front called Homestead Investments, Hackbarth told investors that their money was being used to buy, rehab and sell commercial and residential property, promising a 15% return on the investment notes. Hackbarth never put any of the money into real estate (although he made large donations to the church). Rather, he just used new investors' money to pay off earlier investors -- the hallmark of a Ponzi scheme. The Wisconsin Securities Division issued a Cease & Desist Order and worked with the FBI in a criminal action resulting in a conviction and 10-year prison sentence. This case is also a good example of the affinity fraud aspect that appears so often in the Division's enforcement cases targeting senior investors.

Colorado - Over the years, the Colorado Division of Securities has investigated a number of securities cases involving the exploitation of senior citizens. For instance, in one case, a licensed insurance agent in Colorado took over $760,000 from at least 12 investors who ranged in age between their mid-50's and mid-80's. He sold his victims promissory notes through fraudulent misrepresentations and omission about risks and returns. In a more recent case, another insurance agent defrauded 65 senior citizens through the sale of callable Certificates of Deposit. Both of these cases resulted in criminal prosecution by the Colorado Attorney General's Office.

Florida - Just last week, Florida state officials announced that they have dismantled an Orlando based company, Tropical Village, Inc., they say defrauded elderly investors of more than $9 million through the sale of unregistered securities. The perpetrators targeted 80 wealthy elderly investors, convincing them to invest their money in apartment complexes in several Florida cities, as well as in Texas and Georgia. Instead, more than $8 million of the seniors' money was diverted to the perpetrators' personal use.

Maine - In one case, an insurance sales person from Texas sold Maine senior citizens $1,000,000 worth of securities in the form of promissory notes and investment contracts issued by start-up companies. He was not licensed to sell these products, the products were not registered, and he did not disclose the risks of investing in a start-up company to the investors. Most of these investors were retired, had no investing experience, and invested funds that they needed for living expenses. When the start-up companies failed, the investors lost everything. Through the state Attorney General's Office, the Maine Securities Division prosecuted the sales person, who was convicted of securities fraud and several other securities violations and sentenced to two years in prison. Unfortunately, the victims will never recover their losses.

Missouri - In a recent action, the Securities Division of the Secretary of State's office took enforcement action against a securities agent and the broker-dealer with which he was employed, who had developed a relationship with a large company in St. Louis, Missouri. The agent, who handled the accounts of many retired workers, traded aggressively in accounts of these unsophisticated retirees' and the broker-dealer failed to adequately supervise the agent. These retirees lost millions of dollars in their retirement accounts. A consent order requiring a large fine and restitution was eventually reached.

In a similar matter, a securities agent with a broker-dealer found newspapers announcing a list of retirees from a large Kansas City firm and called these recent retirees. The agent convinced the retirees to purchase mutual funds, and after they lost money in these accounts he switched these customers to variable annuities. Some of these retirees were switched several times resulting in extremely large surrender fees paid by the retirees and large commissions paid to the agent. The Missouri Securities Division is preparing to take administrative action against the agent and the broker-dealer.

Montana - The State Auditor personally prosecuted the largest securities case in the state's history in 2003, and in 2005 the Office assisted with the federal case against the broker. Tom O'Neill was a securities salesperson for USBancorp/Piper Jaffray in Butte, Montana. Over the course of a four-year period, Tom victimized at least 38 of his clients, most of whom were elderly, widowed or disabled. During this period, Tom executed in excess of 6,000 unauthorized trades in primarily technology stocks in their accounts, charging in excess of $600,000 in commission and causing losses in excess of $1 million. One of the victims, a 92-year-old man, had seven speculative trades in his account while he was in a coma and a final trade in his account hours after he had died. The State Auditor's Office took action against Tom, his branch manager, and the company Piper Jaffray, as well as Piper's management team. Piper subsequently settled the matter with the State Auditor's Office. The settlement included restitution to the 38 victims in the amount of $1.5 million, a $1 million fine and an agreement to change its bonus structure so as not to reward salespeople who were the subject of complaints or regulatory actions. With the assistance of the State Auditor's Office, O'Neil was charged by the United States Attorney's Office and is currently serving a term in federal prison.

Oregon - Last year, an Oregon senior was convinced to give her entire retirement savings of $250,000 to an investment adviser who, in turn, lost the entire amount. The Oregon Division of Finance and Corporate Securities, which has seen an increase in unlicensed investment adviser activity, resolved the case through a consent order.

Pennsylvania - The Pennsylvania Securities Commission issued a cease and desist order in June 2005 against the Association of Senior Counselors and an agent to halt the offer and sale of unregistered securities. According to the state, the agent appeared at a senior's home with materials saying he had "credentials you can trust" and "increase your income: while "avoid[ing] risk." An investigation determined that the agent had been charged in Connecticut in 2004 with selling unregistered securities and failing to register as an agent of a securities issuer in connection with the alleged sale of promissory notes.

Texas - In the last two years there has been an enormous problem in Texas with unregistered schemes being sold to elderly investors. These schemes include currency trading programs, promissory notes, viatical settlements, resort timeshare investments and equipment leaseback schemes involving internet kiosks, card readers, and ATM machines. The losses to Texans are estimated to be in the hundreds of millions of dollars. The bait is that the "income" will be "guaranteed" and will be substantially higher than what persons living on fixed incomes can expect to get from certificates of deposit, money market investments or other mainstream financial products.

Promoters of the schemes have been recruiting independent insurance agents and others through advertisements, mailing lists, trade organizations, internet websites, and by word-of-mouth. Agents are often falsely told that the schemes do not involve the sale of securities, are not regulated by state or federal law, and are "safe" or "guaranteed." Generally, lucrative sales incentives or commissions are offered.

Texas securities regulators have sent warning letters to approximately 300 agents that have been identified thus far and have initiated numerous criminal actions.

Investor Education and Senior Outreach Initiatives

State, territorial, and provincial securities regulators believe investor education is a powerful weapon in the fight against investment fraud. For that reason, we actively provide resources to help older investors better educate and protect themselves against investment fraud. Recognizing the value and impact of financial education, NASAA's Board of Directors elevated investor education to Section status in 1997 to help support the ongoing financial education efforts of our members.

Several years ago, a separate Senior Outreach Project Group was created to administer educational campaigns to help fight investment fraud and scams targeted at seniors. State securities administrators from around the country have undertaken a Senior Outreach Initiative that is designed to educate seniors to protect themselves from investment fraud.

The Senior Outreach Initiative involves:

- Promoting programs and materials developed by state securities regulators that include brochures, videos, and outreach seminars presented to organizations such as the Golden Kiwanis and Senior VFW groups.

- Participation as an exhibitor in the 2005 Summer National Senior Olympics. The event drew between 12,000 and 15,000 senior athletes to the southwestern Pennsylvania area and more than 25,000 spectators. NASAA partnered with the Pennsylvania Securities Commission to distribute thousands of investment fraud prevention brochures and fielded hundreds of investor protection-related questions from event attendees.

- Developing an anti-fraud education program that utilizes volunteer/peer group educators and networks. This program is based on highly successful initiatives that have been launched in California and Ontario. The blueprint for this program allows states securities regulators to tailor it and effectively launch it in their own jurisdictions. For example, the proven effectiveness of a comprehensive anti-fraud program begun in California called Seniors Against Investment Fraud, or SAIF, has led to adoption by other states, such as Florida, Pennsylvania and Iowa. In the SAIF model, senior volunteers/peer educators conduct presentations in comfortable, familiar settings such as senior community centers, assisted living facilities and churches investment scams. The program involves training the trainers to conduct the presentations and includes a tool kit and resource guide.

- Educating attendees at the American Society on Aging and the National Council on the Aging's 2006 joint conference. Project group members actively participated in the conference, addressing a workshop entitled "Preying on the Elderly: A Session on Financial Abuse," which featured high-profile speakers (such as an Assistant US Attorney and an FBI agent) involved in combating investment fraud against seniors. The more than 4,000 professionals in attendance at the conference come into contact with senior citizens on a daily basis; reaching thousands of those professionals with the investor protection message and materials in turn potentially reaches hundreds of thousands of seniors.

- Creating an Investment Fraud Bingo Game that delivers important investment protection messages in a fun and interactive format. The game, easy to administer and well received by seniors, is an ideal program for states with limited resources. The program is in use by several states, including Texas, Pennsylvania, Indiana and Florida.

- Forming strategic partnerships with federal, state and local aging networks, including the AARP and US Administration on Aging. Other partnerships under consideration or active engagement include the Retired Senior Volunteer Program and the Investor Protection Trust.

- Developing the Senior Investor Resource Center on the NASAA website to serve as a gateway for important investor protection information designed specifically for seniors. The center, sponsored by NASAA and launched in 2003, includes:

--A checklist of questions seniors should ask before making an investment decision;
--Common sense solutions to protect assets from investment fraud;
--Information about the current top frauds targeting seniors;
--Contact information for securities regulators in each of the 50 states, the District of Columbia, Puerto Rico, Canada, Mexico, and the U.S. Virgin Islands;
--An Investors Bill of Rights and interactive fraud awareness quiz and links to investor education publications and programs offered by state securities regulators and others to help seniors fight investment fraud.

Attached to my written testimony is a compilation of various state investor education outreach programs intended for seniors, and examples of printed materials that are used as newspaper inserts, and distributed at various town hall meetings and community centers throughout the year.

Conclusion

These are dangerous economic times for seniors. Now, more than ever, all American investors – and especially senior investors – need more, not fewer cops on the securities beat. This Committee's examination of investment fraud as it affects the growing senior population is an important step in highlighting the problem and working toward a solution. My office and other State Securities Administrators will continue to play an active role in protecting seniors whether it is a large multi-million dollar scam or a single defrauded senior.

I thank the Chairman and each member of this Committee for allowing me the opportunity to appear today. I look forward to answering any questions you have and providing additional assistance to you in the future.